

MEMORANDUM OF LAW

DATE: March 16, 1989

TO: Larry Grissom, Retirement Administrator

FROM: City Attorney

SUBJECT: Rollover of Tax Deferred Funds

You indicated, in a February 10, 1989 memorandum, that you have received numerous inquiries from employees who are interested in rolling over either Internal Revenue Code section 401(k) or Section 457 Deferred Compensation contributions into the City Employees Retirement System (CERS) in order to buy back years of creditable service in CERS for which they would be otherwise eligible. You asked this office to advise you if such rollovers are authorized.

As you are aware, CERS is a qualified Internal Revenue Code section 401(a) defined benefit pension plan. The City of San Diego's other savings or retirement programs such as 401(k), Deferred Compensation Plan and the Supplemental Pension Savings Plans are all defined contribution plans. The Internal Revenue Code has no provisions permitting a tax-free rollover of contributions held in a defined contribution plan into a defined benefit plan. The reasoning for this is quite simple. Contributions to CERS come from two sources. The first is the employee(s) after tax contribution to his or her individual account and the second is a tax-free contribution to the trust made by the City as the employer. Funds in any of the City's defined contribution plans, with the exception of the employee's contributions to the Supplemental Pension Savings Plan, consist of pre-tax dollars. Because the employee's contribution account in CERS must consist of after tax contributions, the employee cannot make a pre-tax contribution to that account. Even if it were otherwise possible for the employee to make a contribution to CERS with pre-tax dollars to offset the City's contribution those funds would then become the City's contribution to the trust in order to avoid a taxable event. The employee making such a contribution would then lose all rights to those dollars in exchange for the expectancy of a defined benefit upon retirement. The Code does not authorize such a rollover perhaps because of this consequence.

Tax-free rollovers are permitted under Internal Revenue Code section 408, for example, for an individual who desires to rollover pre-tax dollars in a 401(k) Plan to an Individual

Retirement Account. However, if an employee desires to utilize funds in a defined contribution account to buy back the years of service in a defined benefit plan, such as CERS, the employee will be subject to the tax penalties for withdrawing the funds from the defined contribution account (assuming of course that the defined contribution account permits an early distribution). This, of course, also makes such a transaction very unattractive.

In summary, we believe that you should respond to inquiries from employees who are interested in rolling over either 401(k) Plan contributions or Section 457 Deferred Compensation Plan contributions into CERS by merely indicating that, for the above described reasons, the City's 401(k) Plan, Section 457 Deferred Compensation Plan and the Supplemental Pension Savings Plans do not provide for a tax-free rollover into CERS. If the employee inquires about the tax-free rollover capabilities of any other defined contribution account which the employee may have, the employee should be referred to his or her own tax consultant.

JOHN W. WITT, City Attorney

By

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Chief Deputy City Attorney

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